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APPENDIX.

PLAN OF TAX REFORM IN PRUSSIA.

[Translated by R. M. BRECKENRIDGE, *from the Bulletin de Statistique et de Législation Comparée*, December, 1892.]

Before changing the fiscal system of the state in any respect, it is necessary to improve the organization of personal taxes and make a trial of the income tax law of June 24, 1891, which was passed for this purpose. The details of the results obtained from the first levy of this tax have already been stated elsewhere. The principal items only will be repeated here.

For the fiscal year of 1892-93 the assessment estimates promised a return of 124,842,848 marks, 10,056,743 marks from corporations and 114,786,105 from individuals. The estimates for the fiscal year 1891-92, based upon the discontinued monthly returns of the class tax and classified income tax, amounted to 79,558,827 marks. Deducting this sum from the 114,786,105 marks anticipated from personal taxes in 1892-93, we have an income of 35,227,278 marks for the latter fiscal year.

The explanations following show in what proportion this income is to be attributed to changes in the rates on the one hand, and on the other to a more rigorous assessment, and the growth of incomes. In consequence, both of increase in the number of classes and of an advance in the rate to 4 per cent. for incomes over 30,500 marks, incomes over 8,000 marks have given an added return which may be estimated at 8,963,780 marks. But incomes between 900 and 8,000 marks have been relieved to the amount of 4,925,833 marks; hence the net increase is only 4,037,947 marks. The reductions for rate payers with incomes of 900 to 3,000 marks, secured by article 18 of the income tax laws, are not here noted.

Deducting this sum of 4,037,947 marks from the gross increase of 35,227,278 marks, we have 31,189,331 marks, the amount of the increase due either to natural growth of incomes or to improved methods of tax assessment.

The number of persons taxed was, in

1892-93	-	-	-	-	2,435,858
1891-92	-	-	-	-	1,997,638

Increase for 1892-93 - 438,220

The total amount of taxable incomes enjoyed by these persons was, in

1892-93	-	-	-	-	5,724,323,767
1891-92	-	-	-	-	4,273,703,217

Increase for 1892-93 1,450,620,550

It is thus apparent that nearly 8 per cent. of the increase in personal taxes is due, not to an elevation of the tax rate for the higher grades of the schedule, but has arisen rather from those incomes which have heretofore escaped assessment. Compared with the results for 1891-92, the new figures reveal an increase of one-fifth in the number of rate payers and of one-fifth in the amount of taxable income.

Only after several years of trial will the effects of the new law be fully apparent; but the results already obtained permit the inference that the new distribution of taxes is the more equitable, and that the benefits expected have been realized. At the same time, these results show how necessary it was to institute a reform of the income tax. In demanding this the State sought, not to increase its own resources, but to divide more equitably the burden of this tax; and such surpluses as arose were to be applied to the reduction of other contributions. The same motives also prompted the plan agreed upon with the Landtag for continuing the reform already begun in accordance with article 82 of the income tax law.

Thus the State having proposed to renounce the right to impose in its own behalf taxes upon agricultural land and urban real estate, and to assign the revenue thereof to the communes or communal associations, it has decreed that the increase secured from the income tax shall serve to facilitate this measure.

By the exact terms of this promise made to the other provinces, the State might have turned over to the communes nothing more than a share in the land tax and building tax equal to the additional amounts annually derived from the income tax. Such proportion, in this case, would have been equivalent to about one-half of the product of the land and building tax.

This solution, however, apparently very simple, would not have

been satisfactory, for it would have allowed the inconveniences of the old fiscal system to remain, while necessitating the maintenance and development on objective taxes or land; such arrangement would be hard to carry out in Prussia, and, in any case, would be no advance. It has been observed, moreover, that the inconveniences of direct taxes are due to the defective organization of the State impost upon incomes from land.

In order to dispense with the annoyances caused by this system to the State as well as to the communes, the State would have to renounce completely the collection of the land tax and the taxes upon improved real estate and trade.

The accomplishment of this reform requires a complete modification of the whole system of State and communal direct taxes; which change, because of the mutual interest of the State and communes, should be the object of one and the same measure.

To obtain this result the Government proposes to the Landtag three bills providing for the following principal modifications:

1. Renunciation by the State of the collection of taxes upon land income (real or objective taxes) in the form which they have heretofore assumed.
2. Creation by the State of new resources designed to replace the taxes which it relinquishes
3. Establishment of a complementary tax.
4. Regulation of communal finances by means of a law governing communal taxes.

These measures are complementary, their reciprocal dependence being such that the rejection of one of them will entirely destroy the harmony of the system proposed.

I. Renunciation by the State of the Collection of Taxes upon Land.

The question is not one of a new apportionment of State taxes between the State and the communes, but of the State's formal renunciation of the collection of taxes upon land as State imposts.

If the State were to go on apportioning among the communes forty million marks, or any other sum taken from its revenues, with the object of reducing communal burdens, none of the inconveniences previously mentioned would disappear. Even if such were the case, the charges and difficulties incumbent upon the State in the collection of land, building and trade taxes would not be diminished.

The system might, indeed, temporarily lighten the burdens of the communes, but it would not improve the financial situation; besides, an equitable division among communes is much less easy to make than one among counties [*Kreise*].

The division of State funds among the communes may be justified and may result in good when the question for the communes is the satisfaction of obligations incurred for the general interest. But this system of subsidy is anything but commendable from the fiscal point of view, and it in no way favors communal autonomy.

Communal associations, and communes especially, in Prussia, have wide powers in whatever concerns local administration, and the fixing of charges to be undertaken for the communal interests. A necessary complement to these important rights is the power of the communes to assume responsibility for measures taken to regulate and support the communal budget.

It would be very difficult, moreover, to divide funds in proportion to the real needs and respective situations of the several communes; for if the moneys were divided at random, such apportionments might be of no assistance to certain communes, while for others they would be absolutely superfluous.

The communes ought to have full and entire power to establish for themselves sources of revenue adapted to the local conditions, and to use this revenue for their own needs under the proper responsibility of the communal authorities. This result can only be obtained by the State's definitive renunciation of taxes upon real property; on this condition alone can the State tax system be systematically organized, communal imposts conveniently regulated, and the way prepared for a beneficial decentralization.

Following are the taxes renounced by the State:

(a). The tax upon land and upon buildings established by the law of May 21, 1861, and subsequent amendments thereof.

(b). The taxes upon fixed industrial improvements, including the tax upon cultivation established by the law of June 24, 1891.

(c). The taxes upon mines, except upon the working of iron mines. These taxes are assessed at 2 per cent. of the value of the gross product at time of sale. But mine working itself is not subjected to the tax.

We have now to inquire whether the renunciation of these taxes by the State, admitted to be necessary to fiscal reform, may not be open to objections from other points of view.

I. In the first place, this important measure touches the general financial interests of the State.

The taxes upon land and upon urban real estate have always been justly regarded essential sources of the State's revenue, but their abolition as State taxes is possible only on condition that the receipts obtained from them shall be replaced by equivalent resources.

Moreover, the solidity of the State finances in nowise rests upon this form of tax.

The land tax took a certain development at a time when, compared with landed property, other forms of capital and of production were less important factors of general wealth in Prussia.

As long as these economic conditions continued, the direct tax system of the State had its natural basis in the collection of the land tax; the more so, as the personal tax system was then undeveloped. Since then, however, industry and commerce have been enormously extended, the power of transferable capital has considerably increased, and the situation is notably altered. This is well shown by the following table, which exhibits the proportions in which the land tax has contributed to the expenses of the Prussian State.

	1821-Marks	1851-Marks	1892-93-Marks
Product of the land tax and the tax upon buildings.....	28,000,000	30,300,000	15,000,000
Ordinary expenditures except expense of State undertakings.....	150,000,000	209,400,000	931,000,000
Proportion between the product of the land taxes and expenses.....	per cent. 18.7	per cent. 14.5	per cent. 8.0.

On the other hand, the importance of personal taxes is constantly increasing.

One of the principal advantages of land taxes arises from the fact that the product may be relied upon, with almost absolute certainty, not to fall short of the estimates; but long experience now permits so precise a calculation of the product of personal taxes that possible causes of diminution are exactly foreseen. And, besides, the collection of the estimated product is becoming more certain, because a constantly increasing share of the burden of personal taxes is falling upon those classes of the population in easiest circumstances.

While in 1876, the class tax and classified income tax were calculated to produce a total return of about 75½ million marks (the class tax standing for 44½ millions or about three-fifths of this amount), the estimates, for 1892-93, of the income tax upon individuals

amounted to 114,800,000 marks in round numbers, of which only 32,800,000 marks, or less than three-tenths, were to be collected from persons with incomes less than 3,000 marks.

If account is also taken of the income tax collected from corporations, there is obtained a sum of 120,000,000 marks in round numbers; and the collection of this sum is far more certain than was that of the class tax, which rested chiefly upon small incomes, and in 1821 yielded only 19 millions, in 1851 only 23 millions of marks.

Though in times past, the land taxes were often considered valuable sources of revenue in case of war or pressing necessity, it must, however, be acknowledged that such could not be the case to day, for if the commercial and economic situation became unfavorable, the land taxes, as at present levied (unless the charges which encumber lands and improvements are taken into account), could not serve as the basis of an equitable distribution of fiscal charges.

Our whole plan of reform, moreover, tends to adjust the tax system to present conditions, and there is every assurance that, far from being a cause of enfeeblement in the state finances, the adoption of the proposed measures for adjustment will tend, on the contrary, to consolidate them.

II. It should be said that in the old provinces, where the land tax was introduced in 1865, this impost, in consequence of transfers occurring in real estate, acquired, in fact if not in law, the character of a rent charge.

But in the new territories, where this tax was not introduced until 1876 and 1878 (Law of January 3, 1874), this character of rent charge (or identification of tax with income) is altogether unusual, and it would be incorrect to consider this character that the tax may have in certain parts of the kingdom, a sufficient reason to withdraw it from the scope of the reform.

III. Nor, finally, should the State's renunciation of the taxes upon land and buildings be opposed on the pretext that, when these taxes were established, indemnities were granted to persons enjoying privileges of exemption from former land taxes. These indemnities could not be claimed after the landed property has been transferred, otherwise than by inheritance, to third parties who would not have received them; and besides, such considerations are of an altogether secondary order when an admittedly necessary reform is in question.

II. Substitution of New Resources for the Taxes upon Land.

In abandoning the right of laying land taxes, the State relinquishes the following receipts :

	Marks.
Tax upon agricultural land - -	39,907,000
Tax upon improved real estate - -	38,086,000
Tax upon fixed industrial improvements	19,811,000
Tax upon mines - - - - -	6,926,000
Total - - - - -	101,730,000

The round numbers for the land and building taxes and the tax upon mines are those of the budget estimates for 1892-93; for trade taxes, those of the estimates made in accordance with article 81 of the industrial imposts law of June 24, 1891.

The resources destined to cover the deficit caused by the state's renunciation of these taxes are as follows :

1. By virtue of article 82 of the income tax law, all sums over eighty million marks collected as income tax.

The estimated product of this tax for 1892-93 was 124,842,848 marks.

Heretofore the returns from the old income tax and class tax were calculated to fall 3 per cent. short of the estimates. At present, with the new income tax and by reason of numerous claims of rate payers, this shortage may be reckoned at 4 per cent., so that in round numbers the product of the income tax can be estimated at 120,000,000 marks; that is, the 80,000,000 marks already mentioned and a surplus of 40,000,000. For some time, at least until April 1, 1895, the date on which all the laws for the reorganization of the finances are to take effect, it will be expedient not to increase this estimate.

2. The customs duties upon agricultural products, which were heretofore apportioned to the counties [*Kreise*] in accordance with the law of May 14, 1885.

These apportionments amounted

in 1888-89	to	29,585,255	marks
" 1889-90	"	47,364,921	"
" 1890-91	"	47,251,622	"
" 1891-92	"	57,035,130	"

This last amount should be considered as altogether abnormal. Its greatness is due to poor harvests during that fiscal year, a circumstance

which caused an increase of 22,800,000 metric quintals in the imports of cereals over those of the preceding period. And as, on the other hand, the reductions in duties introduced Feb. 1, 1892, may be calculated at 30 per cent. for cereals, it would be unsafe to estimate the average annual sum to be obtained from withdrawing the allotments formerly granted to the several counties, at more than 24,000,000 marks.

3. The state's relinquishment of the collection of taxes upon landed incomes will not permit appreciable economies, for, until further notice, the service for the assessment and collection of the taxes upon lands, buildings and trade will be conducted at the state's expense. But it is estimated that economies of 1,600,000 and of 150,000 marks, for the income and trade taxes respectively, will be possible in the communal share of the expenses for the service of assessment.

Additional economies will be effected in the expenses of collection, as follows:

	Marks.
Tax upon agricultural lands - -	240,000
“ “ urban real estate - -	600,000
“ “ trade - - - -	350,000
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Total - - - -	1,190,000

The situation may be summarized thus:

	Marks.
Estimated deficit caused by the state's relinquishment of tax levies upon landed incomes	101,730,000
Deducting the resources provided to cover this deficit, to wit:	
	Marks.
1. Surplus of the income tax	40,000,000
2. Gains arising from the repeal of the law of May 14, 1885	24,000,000
3. Abolition of communal expenses in the bureau of tax assessment:	
Income tax	1,600,000
Trade tax	150,000
Decrease in cost of collection	1,190,000
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Leaving a sum of	34,790,000
or, in round numbers	35,000,000

which will have to be supplied from other resources.

III. *The Complementary Tax.*

Aside from all considerations of budgetary equilibrium and for reasons quite independent of this question a further modification in the system of state taxes is proposed.

Of the direct taxes, that upon income will be the principal resource of the state, but it ought to be capable of increase even beyond the estimates, by means of a complementary tax.

This provision of the law has not seemed entirely just, for income arising from labor is subject to conditions from which other sources of income are exempt: income from labor, in short, implies continuity of the laborer's effective existence and the permanence of his capacity to work. Under these conditions every person naturally endeavors to save in order to assure the existence of relatives or children in case of his own death, or of the diminution or definitive impairment of his ability to labor. Persons with other sources of income either have less of these cares or none at all; they can, therefore, spare a more considerable part of their income to satisfy the demands of the impost.

The Upper House, by the resolution of May 12, 1891, have also expressed the opinion that a distinction should be made between incomes gained by labor and those arising from properties already realized.

There can be no question of reducing the taxes at present levied upon the least burdened classes: it is well known that, by the law of June 24, 1891, these classes, and even incomes up to 8,000 marks, are not only subjected to rates proportionally lighter, but also enjoy certain advantages and moderations not accorded to the higher classes. If these advantages have not yet been fully realized, it is because of the impossibility heretofore experienced, of accurately basing the tax assessment upon the real value of incomes.

Examination of the accepted estimates for the fiscal year 1892-93 shows that the tax ought to yield a surplus over the former assessment.

	Marks.	Pf.
For incomes of 900-3,000 marks of	1,765,889	25
“ “ “ 3,000-6,000 “ “	2,632,264	00
“ “ “ 6,000-8,000 “ “	527,680	00
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Or a total of - - -	4,925,833	25

But by article 18 of the income tax law, 154,566 rate payers of these classes are exempted from the tax and 543,308 have their payments reduced. These exemptions or reductions amount to 3,456,138 marks, or about 10.53 per cent. of the total (32,835,099 marks) tax levied upon incomes between 900 and 3,000 marks.

As the average income tax levied by the state does not exceed 2.01 per cent., there can be no thought of lowering the rate of this tax.

The only other practical means, therefore, for dividing more equitably the extra burdens laid upon rate payers, is the creation of a new and independent tax upon property [*Vermögenssteuer*], established upon the following principles :

1. All individuals subjected to the income tax shall be subjected to this tax.

2. The tax shall be levied only upon productive capital, real property, and fixed and working capital employed in industry, furniture excepted.

3. Persons whose taxable property does not exceed 6,000 marks and persons whose taxable income does not exceed 900 marks, provided their taxable property does not exceed 16,000 marks, shall be exempted from the tax.

Exceptions shall be made in favor of widows, orphans and persons incapacitated for work.

Taxes upon property may aim at different ends and produce the most diverse effects. Such a tax might so affect properties that a marked decrease of capital would follow.

A tax of this sort was introduced in Prussia by the edict of May 24, 1812, because of the extraordinary expenses imposed upon the country by war. The tax was one of three per cent., payable upon the whole of individual property. The notorious failure of this fiscal measure arose both from the extraordinary rate adopted and from the economic exhaustion of a land which had been obliged to meet enormous war contributions.

Attempts to introduce taxes of this nature have hardly met with more success in the United States.

A progressive tax upon property beginning at the rate of $1\frac{1}{2}$ per mille has lately been introduced in Holland to replace the income tax, but the experiment is too recent to be properly judged.

A tax upon property also exists in most of the Swiss cantons ; in some, as in the canton of Basel, it acts side by side with a general income tax ; in other cantons it is accompanied by nothing but a tax upon the income of labor, and, again, in others it is the only tax.

But in all these examples, in contrast to that proposed for Prussia, this tax exhibits the trait of predominance.

The establishment of a tax upon property has often been considered the first step towards confiscation of fortunes. This reproach cannot be urged against the Prussian project, for the confiscatory

character which a tax may assume is not at all due to the form of contribution demanded, but to the relative amount of this contribution. In this respect an income tax may as easily become the equivalent of a confiscatory measure. But at the moderate rate of one-half per mille the tax upon property cannot be considered dangerous.

Besides, it should be remembered that under the present circumstances this tax is designed solely to facilitate the attainment of the end proposed in introducing the fiscal reform.

It is a necessary complement of the income tax for three reasons:

1. It reaches (allowance being made for debts) those properties in unencumbered and productive capital which survive both the owners' ability to work and the owners themselves.

2. It reaches certain property which the income tax could not touch, for a rate payer can acquire property which produces no income and yet is an addition to his wealth.

3. Finally, the complementary tax ought not to be made merely a means for exactly meeting the deficit caused by the State's relinquishment of taxes upon landed incomes, but it should also constitute a regular source of revenue for the government finances.

Its character as a complementary tax implies that it should give a smaller return than the principal tax. And so the estimated product of the complementary tax for the fiscal year 1892-3, fixed at 35,000,000 marks, amounts to but 28 per cent. of 120,000,000 marks, the estimated product of the income tax for the same period. And, moreover, the law prescribes reduction of the tax rate in case the amount collected should exceed the estimate.

This tax, furthermore, can vary only within certain limits; and if the average rate of return upon capital is assumed to be four per cent., the property tax rate will be a charge of but $1\frac{1}{4}$ per cent. upon the income; this rate added to that of four per cent. levied upon the largest incomes gives a maximum total of $5\frac{1}{4}$ per cent. for all the direct taxes collected by the State upon incomes derived from property.

Compared with corresponding rates of the preceding and analogous taxes, these rates are not at all excessive, and the former bore far more heavily upon landed property. It is true that, according to the new law of June 24, 1891, the charges of the trade tax remain nearly

as they were. But the burdens caused by the tax upon property will be oftenest compensated by the reduction of the *additional* taxes levied by the communes.

IV. Regulation of Communal Finances.

The State's renunciation of the collection of taxes upon income from land will permit the organization of communal finances upon a new basis.

The principle of this organization is the reservation to the communes of the privilege of levying direct taxes upon landed and industrial property for their own account.

This assignment of new resources to the communes will necessitate the promulgation of a special law upon communal finances, for, aside from the provisions of the act of July 27, 1885, there exists no financial legislation in Prussia properly termed communal.

A general law which, however, is to respect as far as possible the autonomy of the communes, is necessary in order to prevent certain abuses, to wit :

1. In case the levy of direct taxes would not be the commune's best means of obtaining new resources, or, indeed, in case there should be no reason to levy these taxes, the other resources of the communes being judged sufficient.
2. In case excessive levies oppress those sources of revenue which should be primarily reserved for the State.
3. In case of a defective distribution of burdens among the various imposts left at the disposal of the commune.
4. In case of disproportional increases of burdens.

In the first and fourth cases the intervention of the law will be necessary in order to remind the communes that the direct tax should be only a subsidiary support and only to the amount by which income from communal property fails to meet the communal obligations.

In the second case the law will make a distinction, not drawn at present, between the fiscal domains of the state and of the communes. The following table, part of the documents collected for the preparation of the law upon communal finances, shows the necessity of this distinction, by exhibiting the distribution in 1891-2 of the total resources of the 205 towns in the Empire of over 10,000 inhabitants :

	Marks	Marks
Total Receipts.....		127,904,601
Local Taxes.....	13,827,900	30,131,379
Dog Tax.....	1,273,029	
Special Real Taxes (Land).....	8,665,438	
Special Personal Taxes.....	380,831	
Indirect Communal Taxes.....	5,984,181	
Remainder.....		97,773,222

The remainder was composed of *additional* communal taxes over and above the direct taxes of the State, and also of special communal taxes upon income, which were really nothing but additions to the State income tax.

For the third case it is necessary to supply the absence of precise experimental data as to the distribution of burdens among the different taxes, especially between personal and real taxes.

By allowing them large discretion in deciding upon *additional* taxes, the existing laws have heretofore left the responsibility of this division almost entirely to the competent authorities, the proportions of the taxes not being fixed except in a theoretical manner. This explains the possibility of such a spectacle as has been seen in certain communes of the Arnsberg district, of the *additional* income tax amounting to 300 per cent., and even 400 per cent., of the principal tax.

In order to place the organization of communal finances upon a better basis, the law is to rest upon the following principles :

1. Restrain as far as possible communal expenses which must be met by the levy of direct taxes, and even recommend, whenever the imperial laws do not forbid, the development of indirect taxes.
2. In the levy of direct taxes, choose real taxes rather than others, and appreciably reduce *additional* taxes upon incomes.
3. Regularly apply the funds arising from real taxes (land) to the payment of those communal expenses the results of which especially benefit landed and industrial property.
4. Permit the communes, with the view of increasing their land tax resources, to establish special taxes upon landed estates and industrial property situate within their jurisdiction.
5. Grant to the communes the power to replace the communal income tax by communal taxes (upon house-rent and dwellings), but

forbid the collection of communal income taxes otherwise than as additions to the State income tax.

6. The reciprocal dependence of the financial organization of communes, districts and provinces necessitates, for the purpose of the provisions of the proposed reform, the simultaneous modification of the several legal prescriptions concerning these organizations.